MCI Telecommunications Corporation
1801 Pennsylvania Avenue N W
Washington, D.C. 20006

MCI

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April 1, 1996
Mr. William F. Caton
Secretary
Federal communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

RE: In the Matter of Implementation of Section 302 of theTelecommunications Act of 1996, CS Docket No. 96-46; and Open Video Systems, In the Matter of Telephone Company-Cable Television Cross-Ownership Rules. Sections 63.54-63.58, CC Docket No. 87-266 (Terminated).

Dear Mr. Caton:

Enclosed herewith for filing are the original and four (4) copies of MCI Telecommunications Corporation's Comments regarding the above-captioned matter.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Comments furnished for such purpose and remit same to the bearer.

Sincerely,

Lawrence Fenster
Senior Regulatory Analyst

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Enclosure

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section 302 of the Telecommunications Act of 1996	)	CS Docket No. 96-46
	)	
Open Video Systems	)	
	)	
In the Matter of	)	
	)	
Telephone Company-Cable Television Cross-Ownership Rules. Sections 63.54-63.58	)	CC Docket No. 87-266 (Terminated)

MCI COMMENTS

I. Introduction

In this Notice of Proposed Rulemaking (Notice), the Commission has asked for comment on a variety of issues pertaining to the implementation of Section 302 of the Telecommunications Act of 1996 (1996 Act).[1] MCI must depend upon its ability to purchase interstate switched and special access at reasonable rates. MCI, in its capacity as a large customer of local exchange company telecommunications services, submits these comments with respect to cost allocation issues raised in this proceeding, based on our analysis that local exchange carrier (LEC) provision of video transport will be cross-subsidized by telecommunications ratepayers. In particular, MCI recommends that the Commission: a) adopt the accounting classifications, subsidiary records, amendments to cost allocation manuals, and other reporting requirements previously utilized to guard

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[1]Telecommunications Act of 1996, Pub. Law No. 104-104, 110 Stat. 56.

against cross-subsidy of video dialtone systems;[2] b) require LECs opting for open video systems (OVS) to file tariffs for their video common carriage services which are unbundled and cost causative; and c) require LECs to charge their programming affiliates the tariffed rates for video carriage; d) require OVS operators to charge their affiliates the same rates they charge their competitors; and e) require OVS operators to make their contracts available for public inspection.

A. The Need For Rules Minimizing The Dangers Of Cross-Subsidization

In its Notice, the Commission proposes questions for comment in order to "...develop a record that will enable us to determine what rules, if any, the Commission needs to adopt to effectuate the statute's requirements."[3] MCI contends that it is imperative that the Commission adopt rules establishing just and reasonable rates for video carriage services. While Congress intended to promote LEC entry into the multichannel video distribution market, it did not intend to promote this entry through means which would be anticompetitive, or through means which would damage the development of competition in other markets for telecommunications services. Consequently, a specific framework affirmative is required for video carriage services to ensure that telecommunications ratepayers are not disadvantaged by LEC entry into the video market.

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[2]RAO Letter 25, 10 FCC Rcd 6008, and Reporting Requirements On Video Dialtone Costs And Jurisdictional Separations For Local Exchange Carriers Offering Video Dialtone Services, DA 95-2036, and AAD No. 95-69.

[3]Notice, para. 4.

B. Statutory Direction

Section 653 of the 1996 Act permits a LEC to request certification as an OVS from the Commission, and requires the Commission to approve or disapprove such a request within 10 days of receipt.[4] A LEC's application as an OVS must certify that it complies with Commission rules governing OVS systems. Among those rules for video carriage the Commission is required to adopt are rules that will "ensure that the rates, terms, and conditions for such carriage are just and reasonable, and are not unjustly or unreasonably discriminatory."[5]

C. Statement of Issues

The Commission asks interested parties to comment on the following issues (among others), keeping in mind that 1) Congress did not "intend that the Commission to impose title II-like regulation"[6]; 2) OVS operators will lack market power vis-à-vis video end users; 3) cable operators will no longer face rate regulation upon entry of an OVS operator into their local multichannel video distribution market; and 4) the Commission will only have ten days to review requests for OVS certification.

Issue 1: "[W]hether market incentives and the need to compete with an incumbent cable operator will ensure that negotiated carriage rates are just and reasonable."[7]

Issue 2: Whether there is a set of market performance criteria, which if met, would establish a presumption that negotiated rates for video carriage are just and reasonable.

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[4]1996 Act, § 653(a)(1)

[5]*Id.*, § 653(b)(1)(A)

[6]Conference Report at 178.

[7]Notice, para. 31.

Issue 3: "[W]hether the Commission should adopt a specific framework for ensuring that carriage rates 'just and reasonable' that would give the open video system operator and programming providers certainty that the rates are reasonable."[8]

II. Will Market Incentives Ensure That Video Carriage Rates Are Just And Reasonable?

Over the last decade, regulators have increasingly attempted to incorporate features of competitive markets into their regulatory approach. This Commission has chosen to fashion regulations which attempt to duplicate the outcomes that a competitive market would realize, in terms of diversity and pricing, if the market in question were actually competitive. This approach was at the heart of the Commission's cable rate regulations which duplicated competitive rates, by eliminating the portion of rates due to the exercise of market power by cable operators. Similarly, the Commission's price cap approach attempts to duplicate competitive market outcomes by limiting price increases to inflation minus the extent to which LEC productivity exceeds a national average. At the heart of the Commission's approach, is the recognition that as long as the market in question is not fully competitive, it may not rely on contracts negotiated in those markets to establish competitive rates. Affirmative attempts to duplicate competitive market outcomes are required.

The Commission requests parties to comment on the feasibility of using market-based rates as a benchmark for just and reasonable rates. MCI contends that market-based rates cannot be applied to the wholesale market for video access and transport. First, the market in question is not competitive. The appropriate product market is the

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[8] *Id.*, at para. 31.

market for wholesale video capacity by programming packagers.[9] The appropriate geographic market is the market of the incumbent cable company(s), since those are the entity(s) programming packagers will be competing against.[10] OVS operators do not compete against cable companies. LEC programming affiliates, and the other programming packagers who purchase video capacity from the OVS operator, compete against incumbent cable companies. There is no alternative supplier of wholesale video access and transport available to programming packagers. The market is certainly not competitive.[11] Consequently, the Commission would not have any basis for concluding that negotiated rates would be competitive. If they are not competitive, the Commission cannot conclude that negotiate rates are just and reasonable. Moreover, the need to compete with cable operators will not exercise pricing discipline on an OVS operator. The opposite is the case. The LEC programming affiliate would prefer to be the only competition to the incumbent cable operator. The LEC has an interest in reserving as much OVS capacity for itself as possible, and disadvantaging other programming packagers.

Second, and most important from MCI's perspective, today's LEC access rates are well above economic cost. Such rates could not be considered just and reasonable.

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[9] The Commission originally believed individual programmers would lease capacity on video dialtone systems on a common carrier basis in order to gain direct access to end users. Instead, packagers of programmers have developed who demand video capacity, and offer bundles of video programming in competition with incumbent cable companies.

[10] Since OVS facilities may cross more than one local franchise area, the geographic market may span more than one local cable franchise area.

[11] Neither is it potentially competitive. There is no other carrier with facilities capable of providing video connections to each subscriber in an incumbent cable company's local franchise area that stands ready to offer two-thirds of its capacity to programming packagers. Moreover, the 1996 Act prohibits resale of OVS facilities, thereby closing off another avenue of potential. See, 1996 Act, § 651(b).

Earnings are historically unprecedented; they are well above the cost of capital. Consequently, revenue from LECs' telecommunications services provide them with a ready source of funds to build and operate OVS. While it is true that most LECs are not opting for sharing under the Commission's price cap rules, it is also true that sharing is a year-to-year option. As a result, LECs may elect to share in a later year, giving them the opportunity to "game" the price cap system in order to subsidize their video ventures.

III. Market Performance Criteria

The Commission asks whether "carriage rates are reasonable if some minimum number of programming providers pay the rates, or if some minimum amount of capacity is taken by unaffiliated programming providers at those rates."[12] This approach will not work, since the market in question is not subject to effective competition. As long as demand for video access and transport is inelastic, OVS operators will find it profitable to raise rates above competitive levels. There will undoubtedly be a "minimum number" of programming packagers willing to pay rates above competitive levels, since there is no alternate supplier of wholesale video access and transport.[13]

IV. Specific Regulatory Framework

The Commission should adopt a specific regulatory framework ensuring that carriage rates are just and reasonable, not only because doing so would provide

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[12] Notice, para. 31.

[13] At some point in the future, for example, when OVS capacity increases so that 10 or more programming packagers would be able to offer a video package to subscribers, it might be possible to conclude from the presence of only one or two programming packagers that rates were not just and reasonable. Currently, OVS systems are not able to accommodate more than two or three unaffiliated programming packagers.

programming providers certainty that their rates are reasonable, but also because it would provide LECs customers a greater measure of certainty that their telecommunications rates are just and reasonable.

A. Cost Allocation

MCI recommends that the Commission first establish mechanisms that track investments and expenses unique to OVS, and investments and expenses shared by OVS and LEC's telecommunications services. The Commission has already expressed concern, that absent these tracking mechanisms, video dialtone systems were not assigned their just and reasonable share of costs.

> We held that although the allocation methodology chosen by Bell Atlantic was not patently unlawful, any technique that relies so heavily on such a small portion of the network to calculate the ratio for allocating all non-incremental shared costs for the entire integrated system, requires investigation.[14]

> We held at that time that we could not reject as patently unreasonable Bell Atlantic's contention that certain costs were unidentifiable as incremental to video dialtone or that it would be unreasonable to allocate such costs as incremental to video dialtone....We stated however, that an investigation of these assertions is warranted.[15]

At a minimum, the Commission should immediately reinstate the accounting classifications, subsidiary records, amendments to cost allocation manuals, and other reporting requirements adopted in the RAO Letter 25, and the Reporting Requirements

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14 In the Matter of Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10, Rates Terms, and Regulations for Video Dialtone Service in Dover Township, New Jersey, Transmittal Nos. 741, 786, CC Docket No. 95-145, para. 23.

15 *Id.*, at para. 29

Order.[16] In addition, for the long-term, the Commission should fully address the dangers to telecommunications customers of cross-subsidizing open video systems, and thereby establish just and reasonable rates for OVS, it must modify Parts 32, 36, 64, and 69 of its rules. For example, it will be necessary develop new categories to identify such items as premise conversion devices, premise distribution cabling, operation support systems for OVS systems, host digital terminals, and optical network units.

B. Congressional Intent Regarding A Specific Regulatory Framework

MCI is mindful of the Commission's concern that its proposed specific affirmative regulatory framework would not be consistent with the conference language that the Commission not impose Title II-like regulations upon OVS operators, and the limited time the Commission will have to approve or disapprove a LEC request for certification as an OVS.[17]

MCI contends that the plain language of the 1996 Act must be given greater weight than a single phrase in the Conference report. There are significant places in Section 653 which clearly require the Commission to impose title II-like regulations.[18] Section 653 also contains numerous provisions limiting the regulatory burden of Title II-like rate determination and nondiscriminatory access requirements.[19] These, and other

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[16]RAO Letter 25, 10 FCC Rcd 6008, and Reporting Requirements On Video Dialtone Costs And Jurisdictional Separations For Local Exchange Carriers Offering Video Dialtone Services, DA 95-2036, and AAD No. 95-69.

[17] Notice at para. 29.

[18] These include the requirement for OVS rates to be just and reasonable; and the for OVS operators not to discriminate "among video programming providers with regard to carriage on its open video system. *Id.*, at § 653(b)(1)(A).

[19] For example, the 1996 Act gives the Commission only 10 days to approve or disapprove a LEC's request for certification as an OVS operator. This will almost certainly guarantee initial acceptance of the LECs request, and places a greater burden of proof on opposing parties during the dispute resolution

provisions pertaining to the regulation of OVS operators, make clear that Congress intended the Commission to utilize Title II regulations, but provide OVS operators some flexibility within that framework, and eliminate the obligation to file a Section 214 application for entry into the video market.

C. MCI OVS Tariff Recommendations

MCI recommends that the Commission require OVS operators to file tariffs for their OVS services accompanied by the supporting documents required under the Commission's existing tariffing procedures. These tariffs should be for unbundled rate elements based on cost causative methods. Given the short time the Commission has to review a LEC request for OVS certification, MCI recommends that the Commission only approve a request which: 1) develops tariffs for unbundled rate elements appropriate for OVS systems; 2) provides cost support for these rate elements; and 3) documents that rates for video transport, access, switched access, etc., are equal to or greater than similar rate elements for interstate telecommunications services.

D. Other Recommendations

A commonly accepted requirement for ensuring nondiscriminatory rates is to require the provider of a monopoly service to impute to itself or to its affiliate the same rate it imposes on its competitors. MCI recommends that the Commission require LEC programming affiliates to maintain records sufficient to demonstrate that they have paid

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process required under the 1996 Act (*Id.*, at § 653(a)(2). The 1996 Act eliminates a requirement that OVS operators "make capacity available on a nondiscriminatory basis to any other person for the provision of cable service directly to subscribers." (*Id.*, at § 651(b). The 1996 Act eliminates another Title II the requirement, the need to obtain a section 214 certificate for the establishment of an OVS (The 1996 Act eliminates another Title II the requirement, the need to obtain a section 214 certificate for the establishment of an OVS (*Id.*, at § 651(c)).

the same rates as nonaffiliated programmers. In addition, those records should be available for FCC review at any time. Finally, MCI supports the Commission's proposal that an OVS operator should be required to make its contracts publicly available. Doing so, will permit interested parties to determine whether they should challenge an OVS certification.

V. Summary

In summary, MCI recommends the Commission: a) immediately reaffirm the accounting classifications, subsidiary records, amendments to cost allocation manuals, and other reporting requirements adopted in the RAO Letter 25, and the Reporting Requirements Order[20]; b) require LECs opting for open video systems (OVS) to file tariffs for their video common carriage services which are unbundled and cost causative; and c) require LECs to charge their programming affiliates the tariffed rates for video carriage; d) require OVS operators to charge their affiliates the same rates they charge their competitors; and e) require OVS operators to make their contracts available for public inspection.

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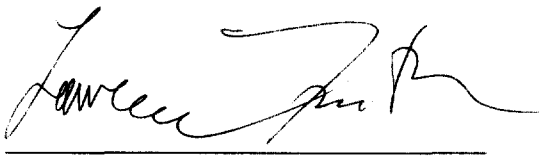
[20]RAO Letter 25, 10 FCC Rcd 6008, and Reporting Requirements On Video Dialtone Costs And Jurisdictional Separations For Local Exchange Carriers Offering Video Dialtone Services, DA 95-2036, and AAD No. 95-69.

STATEMENT OF VERIFICATION

I have read the foregoing and, to the best of my knowledge, information, and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on April 1, 1996.



Lawrence Fenster
1801 Pennsylvania Ave., N.W.
Washington, DC 20006
(202) 887-2180

CERTIFICATE OF SERVICE

I, Stan Miller, do hereby certify that copies of the foregoing Comments were sent via first class mail, postage paid, to the following on this 1st day of April, 1996.

Rick Chessen*
Cable Services Bureau
Room 406F
2033 M. Street, N.W.
Washington, D.C. 20554

Meredith Jones, Chief*
Cable Services Bureau
2033 M. Street, N.W.
Washington, D.C. 20554

Larry Walke*
Cable Services Bureau
Room 408A
2033 M. Street, N.W.
Washington, D.C. 20554

Greg Vogt, Deputy Chief*
Cable Services Bureau
2033 M. Street, N.W.
Washington, D.C. 20554

ITS, Inc.*
1919 M Street, N.W.
Room 246
Washington, DC 20554

* Hand delivered.

Stan Miller